

IT 95-25

Tax Type: INCOME TAX

Issue: Income Earned In Illinois/Individual Residency

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

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DEPARTMENT OF REVENUE      )
STATE OF ILLINOIS          )
                             )   Docket:
      v.                    )   SSN:
                             )
XXXXXX                     )
                             )   Wendy S. Paul
                             )   Admin. Law Judge
      Taxpayer(s)          )
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RECOMMENDATION FOR DISPOSITION

SYNOPSIS: This matter is before this administrative tribunal as a result of a timely protest by XXXXXX (hereinafter referred to as "Taxpayer") to a Notice of Deficiency issued to him on December 15, 1994. The basis of this Notice is the determination of the Department of Revenue (hereinafter referred to as the "Department") that Taxpayer failed to advise the Department of a final federal change for tax year ending December 31, 1990 (hereinafter referred to as the "taxable year"). The Notice asserted an increased tax liability, as well as penalties pursuant to 35 ILCS 5/1005 for failure to pay the entire tax liability by the due date.

In his Protest, Taxpayer contended that the Internal Revenue Service improperly disallowed Schedule C expenses relating to Taxpayer's activities of horse racing and breeding for the subject tax year. Taxpayer alleged that his horse racing and breeding activities were legitimate business activities, and that the reclassification of those expenses as non-deductible hobby expenses by the Internal Revenue Service was improper.

The issues to be resolved are: 1) whether there was a final federal change which increased Taxpayer's adjusted gross income, and, if so, 2)

whether Taxpayer's failure to timely pay his tax liability was due, in whole or in part, to reasonable cause.

A hearing was held on March 31, 1995. Upon consideration of all of the evidence, it is recommended that the tax deficiencies proposed by the Notice be upheld and that the penalties asserted under 35 ILCS 5/1005 be abated.

FINDINGS OF FACT:

1. For the subject tax year, final changes were made to Taxpayer's federal adjusted gross income which correspondingly increased his Illinois base income and resulted in an increased Illinois tax liability. (Department Exh. No. 1)

2. Taxpayer did not report the final federal change to the Department pursuant to 35 ILCS 5/506(a) and (b). (Department Exh. No. 1)

3. Taxpayer filed a timely Protest and Hearing Request, in which he questioned the propriety of the federal changes to his adjusted gross income and in which he also alleged that he was trying to resolve the matter with the Internal Revenue Service. (Department Exh. No. 3)

4. Taxpayer engaged in horse racing and horse breeding activities during the taxable year.

5. At the hearing, Taxpayer did not contest the finality of the federal change but did testify that he thought that his activities relating to horse racing and breeding constituted a legitimate business.

6. Taxpayer's federal and state tax return for the subject tax year were prepared by an accountant and tax preparer whom Taxpayer had also retained in prior years. (Taxpayer Exh. 1)

7. Prior to the preparation of Taxpayer's return, Taxpayer supplied the accountant with all necessary and relevant information for the subject tax year, including all information concerning his horse racing and breeding activities.

8. Taxpayer's accountant advised Taxpayer that his returns were correct as filed and Taxpayer relied upon the accountant's advice.

CONCLUSIONS OF LAW: Any person required to file an Illinois income tax return is required to notify the Department, within the time frame set out by statute, of any final federal change which affects the computation of such person's base income. 35 ILCS 5/506(a)(b). Here, there was such a final federal change which Taxpayer failed to report to the Department. Accordingly, Taxpayer is subject to additional tax for the subject tax year.

In addition to asserting a tax deficiency, the Notice of Deficiency proposed penalties under 35 ILCS 5/1005 for failure to pay the entire tax liability by the due date. Penalties imposed under the provision of this statutory section, however, shall not apply if failure to pay the tax at the required time was due to reasonable cause. 35 ILCS 735/3-8.

The existence of reasonable cause justifying abatement of a penalty is a factual determination that can only be decided on a case by case basis (*Rorabaugh v. United States*, 611 F. 2d 211 (7th Cir.,1979)) and has generally been interpreted to mean the exercise of ordinary business care and prudence (*Dumont Ventilation Company v. Department of Revenue*, 99 Ill.App.3d 263 (3rd Dist. 1981)). The burden of proof is upon a taxpayer to show by a preponderance of the evidence that it acted in good faith and exercised ordinary business care and prudence in providing for the timely payment of its tax liability.

Here, Taxpayer has established the existence of reasonable cause sufficient to justify an abatement of the Section 1005. Taxpayer relied upon the advice of the tax consultant and accountant whom he had retained and whom he had also retained in previous years. Taxpayer supplied all of the relevant and necessary information about his income and expenses to the accountant, who prepared his federal and state returns and who advised

Taxpayer that the returns as filed were correct. I find that Taxpayer's reliance upon the advice of his accountant was in good faith and was reasonable and prudent under the circumstances. Accordingly, reasonable cause exists to abate the penalty portion of the Notice of Deficiency.

It is my recommendation that the additional tax liability proposed in the Notice of Deficiency be upheld and that the penalties proposed be abated.

Wendy S. Paul
Administrative Law Judge

Date: 4/4/95